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INFO RUEHZL/EUROPEAN POLITICAL COLLECTIVE PRIORITY
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RUCPDOC/DEPT OF COMMERCE WASHINGTON DC PRIORITY

UNCLAS SECTION 01 OF 02 BUCHAREST 000424

SENSITIVE

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TREASURY FOR JBAKER AND LKOHLER

SIPDIS

E.O. 12958: N/A
TAGS: EFIN ECON ETRD EIND RO
SUBJECT: ROMANIA AND IMF: COMMERCIAL BANK LENDING STILL WEAK DESPITE
FIVE BILLION DEPOSIT

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¶1. (SBU) Summary. Commercial loans remain scarce, despite the Romanian Central Bank's (BNR) cut in reserve requirements following receipt of the first tranche of five billion euro from the IMF in May. High interest rates on bonds issued by the Government of Romania (GOR) are vacuuming up some of the liquidity in the system, with banks demonstrating a marked preference for 11 percent interest on three- to six-month T-bills rather than accepting the longer maturities, higher risk, and lower yields on offer in the commercial lending market. The Romanian banking system as a whole remains stable; however, the next six months will be hard on some banks thanks to higher default rates on consumer accounts. While the biggest players in the Romanian market should be able to ride out the storm, little new credit is available to any but the most well-established firms. End summary.

¶2. (SBU) In a series of interviews, EconOff "took the pulse" of the largest banks on the Romanian market, starting with French-owned BRD-Societe Generale, the second largest bank. Vice-President Claudiu Cercel explained the sharp 6.2 percent contraction in first quarter GDP was driven by a frozen credit market and that the accompanying reduction in economic activity had increased the risk on banks' balance sheets. Underlining BRD's relatively strong position, Cercel said that at present there is plenty of liquidity in the market, but "prudential" underwriting and the lack of good project proposals have kept loan volumes low. For the most part, both clients and banks have adopted a "wait and see" attitude, expecting continued economic uncertainty through at least the third quarter of 2009. While long-term banking prospects remain good, Cercel highlighted the precarious situation of some Greek and Austrian banks, particularly Alpha Bank, which expanded too aggressively during the boom. As non-performing loan portfolios rise, many banks in Romania have shifted 180 degrees to loss mitigation mode, limiting the supply of new loans. While nobody is likely to withdraw from the market entirely, BRD believes the fragmented market is in need of consolidation. With most of their banking rivals bleeding more severely, the BRD's only significant competition comes from the European Bank for Reconstruction and Development (EBRD) and the European Investment Bank (EIB).

¶3. (SBU) The largest bank in Romania, Austrian-controlled BCR-Erste, has a similar position to their French rivals. Peter Bombeld, BCR's former Director for Corporate Finance and Investment Banking, painted a relatively bleak picture of the health of corporate Romania. (Note: Bombeld had resigned from the bank the day before meeting with EconOff to start his own consulting firm.) In Bombeld's opinion, local companies accustomed to easy money are reluctant to take the painful steps required in the current circumstances. This makes banks reluctant to lend money, because underwriters want to see a credible plan for remaining healthy

through the recession. Agreeing with BCR, Bombeld said that there is enough liquidity on the market, but that there is a shortage of solid, bankable projects. He also noted that losses on loan portfolios are rising. According to Bombeld, real estate has been particularly hard-hit, with some banks, such as Raiffeisen and Alpha, experiencing big increases in non-performing loans. Bombeld was guardedly optimistic that the agriculture, food processing, and healthcare sectors may see some growth this year.

¶4. (SBU) To contrast the views of the bankers with those of the non-financial sector, EconOff met with Ernst and Young Partner Venkatesh Srinivasan, who bluntly said that corporate lending has halted. Srinivasan has clients with bankable projects, but the banks are risk-averse to the point of paralysis. While real estate, retail, and construction are particularly hard hit, Srinivasan said funding was scarce for projects in most sectors. Agreeing that long-standing clients of BRD-Societe Generale, BCR-Erste, and CEC Bank are able to obtain smaller short-term loans, he indicated that larger credit facilities are unavailable, even to creditworthy borrowers. Srinivasan echoed the message that Raiffeisen and Alpha Bank have essentially exited the corporate lending market, and he added ING to the list of banks with little money to lend. By far the most pessimistic of our interlocutors, Srinivasan said he believes that the worst is yet to come, especially in the manufacturing sector.

¶5. (SBU) The BNR's Director of Bank Supervision, Nicolae Cinteza, was more pessimistic than usual on the stability of some local banks. Echoing the message that overall stability is good and liquidity is available, Cinteza said that high interest rates and losses caused by the economic contraction are increasing bank losses. Provisioning against these losses destroyed bank profits in the first quarter. To bolster stability, the BNR has raised solvency requirements from eight to ten percent, a number which

three of the larger banks on the Romanian market are struggling to meet. There is a real concern that the numbers could get worse. Provisioning currently covers 123 percent of the 2.6 billion USD portfolio of overdue loans, but credit quality is worsening, with the weight of "impaired" loans (overdue by less than 90 days) rising to 9.4 percent in March 2009 from 4.4 percent in March 2008. Even so, Cinteza noted that April was a good month, with most banks posting profits. BNR concludes that it is too early to feel the impact of the five billion euro recently received from the IMF. Despite the release of approximately one billion euro on the local market through a reduction in reserve requirements, credit availability has not significantly improved. In fact, outstanding short-term foreign currency debt has dropped by 20 billion euro since November 2008, while the size of credit lines extended to local subsidiaries by foreign parent banks have shrunk over the same period.

¶6. (SBU) In a recent BNR poll, commercial banks said that Romania's riskiest sectors for lending are real estate, construction, transportation, communications, and tourism. Accordingly, for the fourth quarter in a row, 89 percent of the banks have raised collateral requirements, increased down-payments, and added additional risk-associated fees. Banks acknowledge that new loan applications are dropping to unprecedented low levels. What the bankers don't say is that their high interest rates and fees are helping to deter most would-be applicants, with average local currency loan rates (including fees) at a usurious level of 22.5 percent. With the banks able to lend to the Government at an average of 11.07 percent, there is little pressure to open up the taps to the riskier corporate sector.

¶7. (U) A statistical snapshot of bank health shows that interbank lending rates have come down significantly from their October 2008 peak of 22.98 percent, though they still remain high at 10.98 percent. Commercial rates offered by banks on existing leu-denominated deposits climbed from an average of 12.23 percent in October 2008 to 15.57 percent in March 2009 as banks jockey to buttress their balance sheets. Banks have been offering a premium on new deposits, paying an average of 16.2 percent in March 2009 (versus 14.15 percent in October 2008). While total non-government

credit balances have risen by 18.9 percent from April 2008 to April 2009, the recent trend is negative, with a one percent drop between March and April. The leu non-government credit balance was up 7.8 percent between end-April 2008 and end-April 2009. The leu trend is reflected in foreign currency loans, albeit at much lower interest rates.

¶8. (SBU) Comment. Current lending is comprised almost exclusively of credit roll-overs for existing clients, despite the release of one billion euro onto the market in May thanks to the reduction in foreign currency reserve requirements after the IMF disbursement. Post's early analysis is that the "gentlemen's agreement" the IMF obtained from the banks to keep capital in Romania has barely been honored. Most of the banks appear to have continued to reduce foreign currency exposure to the Romanian market, rather than using the released reserves to resume lending. While all the banks claim loans are available, the fact is that a Romanian business applying for a loan today would find the process of actually obtaining credit interminable. As Ernst and Young's Srinivasan put it, "The banks will never say no, they'll just ask for more paperwork." For good or ill the EBRD and the EIB have stepped into the breach, building market share while the commercial banks tread water. While the GOR, including President Basescu himself, has recently taken the banks to task for failing to restart lending, the sad truth is that it is the Government's own financing needs which are equally responsible for crowding out the corporate sector. Lending at 11 percent in three-month installments to a government which has never defaulted is a much safer business decision than lending to a corporate client in a recession, no matter how impaired the Government's official credit rating. End Comment.

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